

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

November 10, 2011

IN RE:	)	
	)	
ATMOS ENERGY CORPORATION	)	Docket No. 11-00195
INCENTIVE PLAN ACCOUNT (IPA) AUDIT	)	

**NOTICE OF FILING BY UTILITIES DIVISION OF
THE TENNESSEE REGULATORY AUTHORITY**

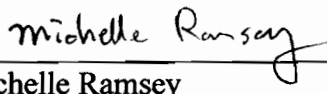
Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Utilities Division of the Tennessee Regulatory Authority hereby gives notice of its filing of the Atmos Energy Corporation Incentive Plan Account (hereafter "IPA") Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Atmos Energy Corporation's (hereafter the "Company") IPA for the period April 2004 through March 2007.
2. In September of 2010, the Company's personnel contacted Audit Staff ("Staff") and requested a meeting to discuss the filing of IPA annual reports. Since that time, Staff has had frequent communications with and/or met with the Company's personnel in order to gather and audit the necessary documentation, from the Company, to support the annual reports. Staff completed its audit on November 9, 2011.

3. The Audit Report is attached hereto as Exhibit A and is fully incorporated herein by this reference.

4. The Utilities Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the same.

Respectfully Submitted:



Michelle Ramsey
Utilities Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of November 2011, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Kenneth C. Hill, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

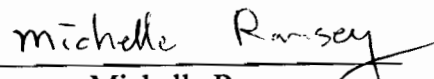
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Michelle Ramsey

COMPLIANCE AUDIT REPORT
OF
ATMOS ENERGY CORPORATION
INCENTIVE PLAN ACCOUNT
DOCKET NO. 11-00195

PREPARED BY
TENNESSEE REGULATORY AUTHORITY
UTILITIES DIVISION

November 2011

EXHIBIT A

**TENNESSEE REGULATORY AUTHORITY'S
COMPLIANCE AUDIT
of
ATMOS ENERGY CORPORATION
INCENTIVE PLAN ACCOUNT**

DOCKET NO. 11-00195

TABLE OF CONTENTS

I. INTRODUCTION	1
II. BACKGROUND AND DESCRIPTION OF PERFORMANCE INCENTIVE PLAN	1
III. JURISDICTION OF TENNESSEE REGULATORY AUTHORITY	3
IV. AUDIT SCOPE	4
V. ACTUAL PLAN YEAR RESULTS	5
VI. IPA AUDIT FINDINGS	6
VII. AUDIT CONCLUSIONS AND RECOMMENDATIONS	10

ATTACHMENT 1 (PERFORMANCE BASED RATEMAKING MECHANISM RIDER)

I. INTRODUCTION AND AUDIT OPINION

The subject of this compliance audit is the Performance Based Ratemaking Mechanism Rider (hereafter "PBRM", "Incentive Plan" or "IPA") of Atmos Energy Corporation (hereafter "Atmos" or the "Company"). The objective of the audit was to determine whether the balance in the Incentive Plan Account (IPA) as of March 31, 2007 was calculated in conformance with the terms of the Incentive Plan and to verify that the factors utilized in the calculations were supported by appropriate source documentation. The IPA addresses sharing incentives with respect to the Company's gas procurement and capacity management activities, which are more fully described in Section II below. After reviewing the Company's filing, Staff found two (2) errors. The Staff concludes that, except for the findings noted in Section VI, during the plan year under review the Company correctly calculated the benefits accruing to Atmos and the ratepayers under the Incentive Plan.

II. BACKGROUND AND DESCRIPTION OF PERFORMANCE INCENTIVE PLAN

On March 31, 1997, United Cities Gas Company¹ filed a petition with the Authority, requesting that its experimental Incentive Plan be approved on a permanent basis. After the Consumer Advocate and Protection Division of the Attorney General's Office ("Consumer Advocate" or "CAPD") intervened, the Authority ordered on May 20, 1997 that a contested case be convened in Docket No. 97-01364. The case was heard in two phases, Phase One on March 26 and 27, 1998 and Phase Two on March 27 and 31, 1998.

The Authority issued its Phase I Order on January 14, 1999 and its Phase II Order on August 16, 1999. The Phase II Order authorized United Cities to continue operating under a modified Incentive Plan. The Incentive Plan automatically rolls over for an additional plan year on each April 1st, beginning April 1, 1999, and continues until the Incentive Plan is either (a) terminated at the end of a plan year by not less than 90 days notice by United Cities to the Authority or (b) modified, amended or terminated by the Authority.

The Incentive Plan consists of two mechanisms: (1) the Gas Procurement Incentive Mechanism, and (2) the Capacity Management Incentive Mechanism. Under the **Gas Procurement Incentive Mechanism**, Atmos retains 50% of the savings on gas purchased below 97.7% of a pre-determined index. Should the Company purchase gas above 102% of the same pre-determined index, the Company is penalized for 50% of the excess. The computations of savings/(losses) are made on a monthly basis. The lower end of the deadband (the range within which no savings or losses are computed), is to be readjusted at the end of every three-year period based on the most recent audited results. The **Capacity Management Incentive Mechanism** encourages the Company to market off-peak unutilized transportation and storage capacity. The associated savings are shared by the ratepayers and the Company on a 90/10 basis. **Interest** is accrued on the outstanding monthly balance in the Incentive Plan Account using the same computation that is provided for in the Authority's Purchased Gas Adjustment Rule 1220-

¹ On September 4, 2002, the Company filed tariffs to officially change its name from United Cities Gas Company to Atmos Energy Corporation. Tariff Filing No. 2002-0967.

4-7-.03(vii).² The specific details of the Incentive Plan are included in United Cities Performance Based Ratemaking Mechanism Rider, which was issued on March 16, 1999 and was effective on April 1, 1999. A copy of this tariff is attached to the report as Attachment 1.

During its audit of the April 1, 2000 to March 31, 2001 plan year, Staff identified six (6) findings amounting to a net over-recovery of \$580,742, four (4) of which were contested by the Company.³ The Consumer Advocate filed its petition to intervene on April 15, 2002. The litigation of this docket was protracted, culminating with the filing of the *Initial Order of Hearing Officer on the Merits* on March 14, 2006. Atmos filed a motion for TRA Review of the Hearing Officer's Order on May 3, 2006. On May 13, 2008, the TRA issued its *Order Affirming, in Part, and Vacating, in Part the Hearing Officer's Initial Order*. Atmos was ordered to file all outstanding PBR reports.⁴

Atmos delayed its filing of ten (10) outstanding annual reports until 2011. In September of 2010, the Company contacted Staff and requested a telephone conference to discuss the filing of these reports. Since that time Staff has frequently communicated with and/or met with Company personnel in order to gather and review the necessary documentation to support the annual reports.⁵ Staff considered various approaches to efficiently complete the audits, from auditing three (3) years at a time to auditing all ten (10) years in one filing. When Staff recently discovered that sharing of asset management fees under the current PBRM tariff was an issue that the Company would most likely contest, Staff proposed separating the audits into three (3) years and seven (7) years.⁶ Staff was anticipating that the Company would soon file the first three (3) annual reports with the Authority for audit. On August 23, 2011, Atmos changed course and filed a *Petition*⁷ with the Authority requesting approval of its Incentive Plan reports for the period April 1, 2001 through March 31, 2011.

On September 8, 2011, Staff requested that a docket be opened for the purpose of issuing an audit report for the first three (3) years (April 1, 2001 through March 31, 2004). The audit was complete and Staff and Atmos had agreed on the ending balance in the IPA account at March 31, 2004. On November 4, 2011, the parties to Dockets 11-00158 and 11-00137 filed a Stipulation to dismiss Docket 11-00137 and to state that Staff's audit report in Docket 11-00158 was unopposed. The Staff's audit report was brought before the Panel of Directors at a regularly scheduled Authority Conference on November 7, 2011. The audit report was approved by the Directors and Atmos was ordered to file the tariffs to refund the credit balance of \$213,781.78 in the IPA Account with an effective date of December 1, 2011.

² TRA Final Order on Phase Two, Docket No. 97-01364, August 16, 1999, page 28, paragraph 12. See Attachment 10.

³ *In Re: Audit of United Cities Gas Company's Incentive Plan Account (IPA) for the Period of April 1, 2000 through March 31, 2001*, Docket No. 01-00704, Staff Audit Report (April 10, 2002).

⁴ *Initial Order of Hearing Officer on the Merits*, page 37 (March 14, 2006). Although the Initial Order was reversed in part as to the proposed TIF tariff amendment, the voting panel did not reverse those rendering clauses of the Initial Order that related to the existing PBR tariff.

⁵ Atmos provided to Staff copies of all invoices received during the audit period.

⁶ The inclusion of asset management payments for sharing under the plan started in Year 4. At the end of Year 3, there exists a net refund due to customers that Staff did not want to withhold from customers until the conclusion of a possible contested hearing.

⁷ *In Re: Petition for Approval of Incentive Plan Account Reports for the Period April 1, 2001 through March 31, 2011* (August 23, 2011). Docket No. 11-00137.

The Stipulation also detailed a proposed procedure to expedite the approval process for the remaining annual reports filed in Docket 11-00137. The first step entails Audit Staff filing its report on the next three-year period no later than November 10, 2011.

Pursuant to the Stipulation, on November 8, 2011, Staff requested that a docket be opened for the purpose of issuing an audit report for the second three (3) years (April 1, 2004 through March 31, 2007).

III. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (hereafter "T.C.A.") gave jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. § 65-4-104 states:

The Authority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. § 65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. has conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. § 65-3-108, said power includes the right to audit:

The department is given full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

The Authority's Utilities Division is responsible for auditing those companies under the Authority's jurisdiction to insure that each company is abiding by the rules and regulations of the TRA. This audit was performed by Michelle Ramsey and Helen Trimble-Anthony of the Utilities Division.

IV. AUDIT SCOPE

The IPA audit is a compliance audit of the Company's Incentive Plan Account.⁸ The audit goal is to verify that the Company's calculations of incentive gains and losses are materially correct,⁹ and that the Company is in compliance with all terms of its tariff and following all Authority orders and directives with respect to its calculation of the IPA Account balance.

To accomplish the audit goal, Staff reviewed the Company's tariff, gas supply invoices, pipeline tariffs, supplemental schedules and other source documentation provided by Atmos, and industry publications to verify the indexes used to calculate the benchmarks, as well as prior Staff audits and Authority Orders. Where needed, Staff contacted the Company to obtain additional information to clarify the filing.

⁸ See Attachment 1, TRA No. 1, 2nd Revised Sheet No. 45.

⁹ The audit goal is not to guarantee that the Company's results are 100% correct. Where it is appropriate, Staff utilizes sampling techniques to determine whether the Company's calculations are materially correct. Material discrepancies would dictate a broadening of the scope of Staff's review.

V. ACTUAL PLAN YEAR RESULTS

According to the Company's reports, the Incentive Plan generated \$1,125,790 in total incentive savings. Of this amount, \$1,013,211 benefited the ratepayer and \$112,579 was retained by Atmos. Adding the over-recovered balance from the previous audit period and accrued interest on the monthly balances, and subtracting the surcharges recovered from customers during the audit period, resulted in an **over-recovered balance** in the IPA Account at March 31, 2007 of **\$127,712.51**

The following chart summarizes the results of the three-year period under the Incentive Plan, as presented in the Company's reports:

	<u>Year Ended 3/31/05</u>	<u>Year Ended 3/31/06</u>	<u>Year Ended 3/31/07</u>
Total Actual Purchases¹⁰	<u>\$100,632,440</u>	<u>\$143,799,033</u>	<u>\$101,188,871</u>
Total Annual Benchmark¹¹	<u>\$100,960,125</u>	<u>\$144,132,171</u>	<u>\$102,155,670</u>
Percentage Actual Purchases to Benchmark	99.7%	99.8%	99.1%
Total Incentive Savings (Losses) from:			
Gas Procurement	\$0	\$0	\$0
Capacity Management ¹²	<u>\$ 420,872</u>	<u>\$ 377,021</u>	<u>\$ 327,897</u>
<u>Total Incentive Savings</u>	<u>\$ 420,872</u>	<u>\$ 377,021</u>	<u>\$ 327,897</u>
Incentive Savings(Losses) retained by Ratepayers:			
Gas Procurement	\$0	\$0	\$0
Capacity Management	<u>\$ 378,785</u>	<u>\$ 339,319</u>	<u>\$ 295,107</u>
<u>Total Incentive Savings to Ratepayers</u>	<u>\$ 378,785</u>	<u>\$ 339,319</u>	<u>\$ 295,107</u>
Incentive Savings (Losses) retained by Company:			
Gas Procurement	\$0	\$0	\$0
Capacity Management	<u>\$ 42,087</u>	<u>\$ 37,702</u>	<u>\$ 32,790</u>
<u>Total Incentive Savings to Company</u>	<u>\$ 42,087</u>	<u>\$ 37,702</u>	<u>\$ 32,790</u>

¹⁰ Includes NORA purchases.

¹¹ Ibid.

¹² Includes 10% of Asset Management upfront payment

VI. IPA AUDIT FINDINGS

Staff reviewed the purchasing activities and capacity management activities of Atmos to determine whether the Company correctly calculated the amount of gains and losses under its Incentive Plan and whether it complied fully with the terms of its tariff. The period April 1, 2004 to March 31, 2007 is the subject of this audit. Staff's audit revealed two (2) findings, which represent an increase of \$117,186.81 in the Company's reported over-recovered balance in the Incentive Plan Account as of March 31, 2007. The correct ending balance in the IPA account is **\$244,899.32 over-recovery**. A summary of the IPA account as filed by the Company and as adjusted by the Staff is shown below, followed by a description of the findings.

SUMMARY OF THE IPA ACCOUNT:

	Company	Staff	Difference (Findings)
Under-recovered IPA Account Balance at 3/31/04	\$(213,781.78)	\$(213,781.78)	\$0.00
Plus Gas Procurement Savings Accruing to Atmos	0.00	0.00	0.00
Plus Capacity Mgt. Savings Accruing to Atmos	112,579.00	9,698.51	(102,880.49)
Minus Amount Recovered from Customers (4/1/04-3/31/07)	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Equals IPA Balance Before Interest	\$(101,202.78)	\$(204,083.27)	\$(102,880.49)
Plus Interest Calculated on Monthly Balances	<u>(26,509.73)</u>	<u>(40,816.05)</u>	<u>(14,306.32)</u>
Equals IPA Account Balance at 3/31/04	<u>\$(127,712.51)</u>	<u>\$(244,899.32)</u>	<u>\$(117,186.81)</u>

SUMMARY OF FINDINGS:

See page

FINDING #1	Capacity management Mechanism	\$(102,880.49)	Over-recovery	7
FINDING #2	Interest on Account Balance	<u>\$ (14,306.32)</u>	Over-recovery	9
Net Result		<u>\$ (117,186.81)</u>	Over-recovery	

FINDING #1:

Exception

The Company over-stated the amount available for sharing between the Company and its ratepayers under the Capacity Release Incentive Mechanism. The Company included \$1,028,805 in Asset Management Fees. Therefore, the Company's share of "savings" was overstated by \$102,880.

Discussion

Staff avers that inclusion of the fees paid by asset managers is not provided for in the Company's current Incentive Plan tariff. The tariff reads:

"To the extent the Company is able to release **daily** transportation or **daily** storage capacity, the associated **savings** will be shared by the Company's customers and the Company on a 90/10 basis. The sharing percentages shall be determined based on the actual demand costs incurred by the Company (exclusive of credits for capacity release) for transportation and storage capacity during the plan year, as such costs may be adjusted due to refunds or surcharges from pipeline and storage suppliers. Any incentive savings or cost, resulting from adjustments to the sharing percentages caused by refunds or surcharges shall be recorded in the current Incentive Plan Account (IPA)." (Emphasis added.)¹³

The Capacity Management Incentive Mechanism permits the Company to share in profits generated from its marketing of any excess storage or pipeline capacity or gas that it has reserved for its customers, but is not currently needed to serve those customers. The calculation of profits or "savings" is based on the comparison of the Company's cost and price paid by off-system customers. If the price paid is greater than the Company's cost, then a profit results and is permitted to be included for sharing under the terms of the Incentive Plan. The wholesale gas markets are markedly different today than when the Company's Incentive Plan was first crafted in 1999. In 1999, the function of utilities selling unused capacity or unused gas to help reimburse ratepayers for the amount they paid for gas and pipeline and storage capacity was recognized as beneficial for the ratepayers. By incentivizing (i.e. rewarding) utilities for increasing this activity, resulted in benefits for both the Company and the ratepayer.

Starting in 2004, Atmos began selecting an outside Asset Manager to deal with the capacity management function in exchange for a fee. The fee paid to Atmos gives the Asset Manager the right to re-market Atmos's assets (for its own gain) when they are not needed by Atmos's customers. The Company included this fee each plan year as part of the Capacity Management Incentive Mechanism. Staff avers that the language of the Incentive Plan does not provide for the outsourcing of this capacity release function. The concept of an asset manager

¹³ See Attachment 1, TRA No. 1, 1st Revised Sheet No. 45.2.

separate from the utility was unheard of in 1997. Therefore, although Staff agrees that the general intent of an incentive plan should encompass all purchasing activities of a company, an outside asset manager was not addressed or even anticipated when the Authority deliberated the establishment of an incentive mechanism for Atmos.¹⁴

Staff has several reasons for believing that the Incentive Plan as written does not include the concept of an outside asset manager. First, the language of the Incentive Plan tariff makes no mention of an outside asset manager. The terms of the tariff address efforts by the Company. In fact, the asset manager concept was not even utilized in 1997. Second, use of an outside asset manager does not allow for calculation of savings as stipulated in the tariff language. "Profits" as such cannot be determined or audited by Staff. Transparency of transactions is very important and does not exist in an asset management arrangement. Third, an incentive plan should provide an incentive for the Company to move *beyond its normal prudent purchasing activity* and incur some risk for doing so, in exchange for the possibility of rewards. With the introduction of an asset manager, the terms of the incentive plan should be revisited.

Therefore, Audit Staff eliminated the Asset Management payments and adjusted the Company's Capacity Management saving amount to \$9,698.51. The effect of this finding is an **increase in the Company's reported over-recovered IPA Account Balance at March 31, 2017 of \$102,880.**

¹⁴ A similar observation was made by Staff in the Atmos Docket 01-00704, where Staff maintains that transportation discounts were not anticipated in the original incentive plan and therefore, not specifically provided for.

FINDING #2:

Exception

The Company under-stated the amount of interest due to customers in the IPA filing by \$14,306.32.

Discussion

Staff recalculated interest based upon audit Finding #1 above. The result is an **increase in the Company's reported over-recovered IPA Account Balance at March 31, 2007 of \$14,306.32.**

VII. AUDIT CONCLUSIONS AND RECOMMENDATIONS

Atmos, **except for** the findings noted, has correctly calculated its share of savings under its Performance Based Ratemaking Mechanism Rider¹⁵ for the plan years ended March 31, 2005, March 31, 2006, and March 31, 2007. The balance in the IPA Account as of March 31, 2007 is \$(244,899.32). This balance will serve as the beginning balance for the next year's calculations. **Staff recommends approval of the Company's adjusted IPA Account balance.**

The Incentive Plan states that at the end of every three-year period, the lower end of the deadband will be adjusted to 1% below the most recent audited results.¹⁶ The lower limit of the deadband for plan years ending March 2006, March 2007 and March 2008 was determined based on the results of Staff's audit report in Docket No. 11-00158¹⁷. Therefore, the results of the audited plan year ending March 2007, less 1% or 98.1%, will establish the lower end of the deadband for plan years ending March 2009, March 2010 and March 2011.

Staff recommends that the Authority direct the Company to file tariffs to refund the credit balance of \$244,899.32 in the IPA Account within thirty (30) days of the approval of Staff's audit report.

¹⁵ See Attachment 1, TRA No. 1, 2nd Revised Sheet No. 45.

¹⁶ See Attachment 1, TRA No. 1, 1st Revised Sheet No. 45.2.

¹⁷ *In Re: Audit of Atmos Energy Corporation's Incentive Plan Account (IPA) for the Period of April 1, 2001 through March 31, 2004*, Docket No. 11-00158, Staff Audit Report (October 4, 2011 along with the amendment filed on October 21, 2011).

ATTACHMENT 1

PERFORMANCE BASED RATEMAKING MECHANISM RIDERApplicability

The Performance-Based Ratemaking Mechanism (the PBRM) replaces the reasonableness or prudence review of the Company's gas purchasing activities overseen by the Tennessee Regulatory Authority (the Authority) in accordance with Rule 1220-4-7-.05, Audit of Prudence of Gas Purchases. This PBRM is designed to encourage the utility to maximize its gas purchasing activities at minimum costs consistent with efficient operations and Service reliability, and will provide for a shared savings or costs between the utility's customers and share holders. Each plan year will begin April 1. The annual provisions and filings herein will apply to this annual period. The PBRM will continue until it is either (a) terminated at the end a plan year by not less than 90 days notice by the Company to the Authority or (b) modified, amended or terminated by the Authority.

Overview of Structure

The Performance-Based Ratemaking Mechanism consists of two parts:

Gas Procurement Incentive Mechanism
Capacity Management Incentive Mechanism

The Gas Procurement Incentive Mechanism establishes a predefined benchmark index to which the Company's commodity cost of gas is compared. It also addresses the use of financial instruments or private contracts in managing gas costs. The net incentive savings or costs will be shared between the Company's customers and the Company on a 50% / 50% basis.

The Capacity Management Incentive Mechanism is designed to encourage the Company to actively market off-peak unutilized transportation and storage capacity on upstream pipelines in the secondary market. The net incentive benefits will be shared between the Company's customers and the Company on a 90% / 10% basis.

The Company is subject to a cap on overall incentive savings or costs on both mechanisms of \$ 1.25 million annually.

Gas Procurement Incentive Mechanism**Commodity Costs:**

On a monthly basis, the Company will compare its commodity cost of gas to the appropriate benchmark amount. The benchmark amount will be computed by multiplying actual purchase quantities for the month, including quantities purchased for injection into storage, by the appropriate price index. For monthly spot

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purchases, the price index will be a simple average of the appropriate *Inside FERC Gas Market Report*, *Natural Gas Intelligence*, and NYMEX indexes for that particular month. For swing purchases, the published *Gas Daily* rate for the first business day of gas flow will be used as the index. For long-term purchases, i.e., a term more than one month, these indexes will be adjusted for the Company's rolling three-year average premium paid to ensure long-term supply availability during peak periods. For city gate purchases, these indexes will be adjusted for the avoided transportation costs that would have been paid if the upstream capacity were purchased versus the demand charges actually paid to the supplier.

Gas purchases under the Company's existing seven-year Nora supply contract effective November 1, 1993, will be excluded from the incentive mechanism. The Company will continue to recover 100% of the Nora and through its PQA with no savings or loss potential. If, upon the expiration of the current Nora contract if the Company continues to operate under the PBRM, the contract is renewed or renegotiated, it will be considered for inclusion in the PBRM at that time.

If the total commodity cost of gas in a month falls within a deadband of 97.7% to 102% of the total of the benchmark amounts, there will be no incentive savings or costs. If the total commodity cost of gas falls outside of the deadband, the amount falling outside of the deadband shall be deemed incentive savings or costs under the mechanism. Such savings or costs will be shared 50/50 between the Company's customers and the Company. At the end of each three-year period, the deadband will be readjusted to 1% below the most recent annual audited results of the incentive plan.

Financial Instruments or Other Private Contracts

To the extent the Company uses futures contracts, financial derivative products, storage swap arrangements, or other private agreements to hedge, manage or reduce gas costs, any savings or costs will flow through the commodity cost component of the Gas Procurement Incentive Mechanism.

Capacity Management Incentive Mechanism

To the extent the Company is able to release daily transportation or daily storage capacity, the associated savings will be shared by the Company's customers and the Company on a 90/10 basis. The sharing percentages shall be determined based on the actual demand costs incurred by the Company (exclusive of credits for capacity release) for transportation and storage capacity during the plan year, as such costs may be adjusted due to refunds or surcharges from pipeline and storage suppliers. Any incentive savings or cost, resulting from adjustments to the sharing percentages caused by refunds or surcharges shall be recorded in the current Incentive Plan Account (IPA).

ATMOS ENERGY CORPORATION**Affiliate Transactions**

The following guidelines present the minimum conditions deemed necessary to ensure that affiliate transactions between the Company and its affiliate(s) do not result in a competitive advantage over others providing similar services. These guidelines will remain in effect as long as the Company is operating under a performance based ratemaking plan. We note that these guidelines may fail to anticipate certain specific methods by which such advantages may be conferred by the Company on its marketing affiliates. All parties should be aware that to the extent such instances arise in the future, they will be judged according to this stated intent.

Definitions:

Terms used in these guidelines have the following meanings:

1. Affiliate, when used in reference to any person in this standard, means another person who controls, is controlled by, or is under common control with, the first person.
2. Control (including the terms "controlling", "controlled by", and "under common control with"), as used in this standard, includes, but is not limited to, the possession, directly or indirectly and whether acting alone or in conjunction with others, of the authority to direct or cause the direction of the management or policies of a company. Under all circumstances, beneficial ownership of more than ten percent (10%) of voting securities or partnership interest of an entity shall be deemed to confer control for purposes of these guidelines of conduct.
3. Marketing, as used in this standard, means selling or brokering natural gas to any person or entity, including the Company, by a seller that is not a local distribution company.

RFP Procedures for Selection of Asset Manager and/or Gas Provider:

1. In each instance in which Atmos Energy Corporation (Company) intends to engage the services of an asset manager to provide system gas supply requirements and/or manage its assets regulated by the Tennessee Regulatory Authority (TRA), the Company shall develop a written request for proposal (RFP) defining the Company's assets to be managed and detailing the Company's minimum service requirements. The RFP shall also describe the content requirements of the bid proposals and shall include procedures for submission and evaluation of the bid proposals.
2. The RFP shall be advertised for a minimum period of thirty (30) days through a systematic notification process that includes, at a minimum, contacting potential asset managers, including past bidders and other approved asset managers, and publication in trade journals as reasonably available. This thirty (30) day minimum period may be shortened with the written consent of the TRA Staff to a period of not less than fifteen (15) days.
3. The procedures for submission of bid proposals shall require all initial and follow-up bid proposals to be submitted in writing on or before a designated proposal deadline. The Company shall not accept initial or follow-up bid proposals that are not written, or that are submitted after the designated proposal deadline. Following receipt of initial bid proposals, and on a non-discriminatory basis, the Company may solicit follow-up bid proposals in an effort to obtain the most overall value for the transaction.

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4. All initial and follow-up bid proposals shall be evaluated as they are received. The criteria for choosing the winning bid proposal shall include, at a minimum, the following: (a) the total value of the bid proposal; (b) the bidder's ability to perform the RFP requirements; (c) the bidder's asset management qualifications and experience; and (d) the bidder's financial stability and strength. The winning bid proposal shall be the one with the best combination of attributes based on the evaluation criteria. If, however, the winning bid proposal is lower in amount than any other initial or follow-up bid proposal(s), the Company shall explain in writing to the TRA why it rejected each higher bid proposal in favor of the lower winning bid proposal. The Company shall maintain records demonstrating its compliance with the evaluation and selection procedures set forth in paragraph 4 above.
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5. An incumbent asset manager shall not be granted an automatic right to match a winning bid proposal. If the incumbent asset manager desires to continue its asset management relationship with the Company after expiration of its asset management agreement, it shall submit a written bid proposal in accordance with the Company's RFP procedures. The bid proposal shall be evaluated pursuant to the procedures set forth in paragraph 4 above.
- N
6. The Company May develop additional procedures for asset management selection as it deems necessary and appropriate so long as such procedures are consistent with the agreed-upon procedures described herein.
- N
7. The Company shall retain all RFP documents and records for at least four (4) years and such documents and records shall be subject to the review and examination of the TRA staff. The Asset Manager shall maintain documents and records of all transactions that utilize the Company's gas supply assets. All documents and records of such transactions shall be retained for two years after termination of the agreement and shall be subject to review and examination by the Company and the TRA Staff.

Standards of Conduct:

The Company must conduct its business to conform to the following standards:

1. If there is discretion in the application of tariff provisions, then the Company must apply such provisions relating to any service being offered in a consistent manner to all similarly situated entities.
2. The Company must strictly enforce a tariff provision for which there is no discretion in the application of the provision.
3. The Company must process all similar requests for services in the same manner and within the same period of time.
4. The Company may not give its marketing affiliate preference over nonaffiliated companies in natural gas supply procurement activities.
5. The Company may not give its marketing affiliate preference over nonaffiliated companies in its upstream capacity release activities.

6. The Company may not disclose to its marketing affiliate any information that the local distribution company receives from a non-affiliated marketer, unless the prior written consent of the parties to which the information relates has been voluntarily given.
7. To the extent the Company provides information related to its natural gas supply activities and upstream capacity release activities, it must do so contemporaneously to all nonaffiliated marketers, that have submitted a written request for such information to the Company.
8. To the extent the Company provides information related to natural gas services being offered to a marketing affiliate, it must do so contemporaneously to all non-affiliated marketers, that have submitted a written request for such information to the Company.
9. In transactions that involve either the purchase or receipt of information, assets, goods or services by the Company from an affiliated entity, the Company shall document both the fair market price of such information, assets, goods, and services and the fully distributed cost to the Company to produce the information, assets, goods or services for itself.
10. When the Company purchases information, assets, goods or services from an affiliated entity, the Company shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.
11. To the maximum extent practicable, the Company's operating employees and the operating employees of its marketing affiliate must function independently of each other. For the purposes of these guidelines, operating employees are those who are in any way involved in identifying and contracting with customers, locating gas supplies, making any and all arrangements with intervening pipelines and in any way managing or facilitating those contracted services.
12. The Company must maintain its books of accounts and records separately from those of its affiliate.
13. If the Company offers a discount to an affiliated marketer, it must make a comparable offer contemporaneously available to all similarly situated non-affiliated marketers.
14. The Company may not condition or tie its agreement to release its dedicated, stored, inventoried or optioned gas or supply contracts or upstream transportation and storage contracts to an agreement with a producer, customer, end-user or shipper relating to any service by its marketing affiliate, any services offered by the Company on behalf of its marketing affiliate, or any services in which its marketing affiliate is involved.
15. Prearranged, non-posted, capacity release transactions may not be entered into with any affiliate of the Company in any two consecutive thirty-day periods.
16. The Company must maintain a written log of tariff provision waivers which it grants. It must provide the log to any person requesting it within 24 hours of request. Any waivers must be granted in the same manner to the same or similar situated persons.

17. The Company shall maintain sufficiently detailed records that compliance with these guidelines can be verified at any time.

Complaints:

Any party may file a complaint relating to violations of these guidelines.

1. Any customer, marketer, or other interested third-party may file a complaint with the Authority relating to alleged violations of the affiliate standards set forth in these guidelines. At or before the time of filing, the complainant shall serve a copy of the complaint on the Company.
2. Within ten (10) days of service of the complaint upon the Company, the Company shall file a written response to the complaint with the Authority.
3. The Authority may hold hearings on any complaint filed or may take such other action (as it may deem appropriate), including requesting further information from the parties or dismissing the complaint.
4. After notice and opportunity for a hearing, should the Authority find that the Company has violated the standards contained in these guidelines, the Authority may impose any penalty or remedy provided for by law.

Reserve Margin

The Company may maintain a reserve of natural gas in excess of its projected peak day requirement and recover the cost of the reserve from their customers through the purchased gas adjustment (PGA). The projected peak day requirement shall be based upon a five-year recurrence interval or the coldest day expected in a five-year period. All firm peak day capacity contracted for by the Company, excluding the daily delivery capacity of liquefied natural gas and propane storage facilities, shall be considered as gas available to meet peak day demand. "Contract demand" shall be the amount of firm peak day capacity the Company is entitled to on a daily basis, pursuant to contract. The maximum peak day firm demand of the projected heating season shall form the base period demand to establish the Company's maximum peak day firm demand. A reserve margin of 7.5% or less in excess of the base period firm demand adjusted for specific gain or loss of customers and/or throughput on a specific case by case basis will be presumed reasonable.

All capacity available to meet the peak day demand in excess of an amount needed to meet the base period peak day demand plus a 7.5% reserve margin must be shown by the Company to be necessary to meet its customers' requirements before it can be included in the PGA. All capacity available to meet demand less than an amount of base period demand plus a 7.5% reserve margin is presumed to be reasonable unless a factual showing to the contrary is made.

Determination of Shared Savings

Each month during the term of the PBRM, the Company will compute any savings or costs in accordance with the PBRM. If the Company earns any savings, a separate below the line Incentive Plan Account (IPA) will be debited with such savings. If the Company incurs any costs, that same IPA will be credited with such costs. During a plan

year, the Company will be limited to overall savings or costs totaling \$1.25 million. Interest shall be computed on balances in the IPA using the same interest rate and methods as used in the Company's Actual Cost Adjustment (ACA) account. The offsetting entries to IPA savings or costs will be recorded to income or expense, as appropriate.

Savings or costs accruing to the Company under the PBRM will form the basis for a rate increment or decrement to be filed and placed into effect separate from any other rate adjustments to recover or refund such amount over a prospective twelve-month period.

Each year, effective October 1, the rates for all sales customers will be increased or decreased by a separate rate increment or decrement designed to amortize the collection or refund of the March 31 IPA balance over the succeeding twelve month period. The rate increment or decrement will be established by dividing the March 31 IPA balance by the appropriate sales billing determinants for the twelve months ended March 31. During the twelve-month amortization period, the amount collected or refunded each month will be computed by multiplying the sales billing determinants for such month by the rate increment or decrement, as applicable. The product will be credited or debited to the IPA, as appropriate. The balance in the IPA will be tracked as a separate collection mechanism. Each October 1 the unamortized amount of the previous year's IPA balance will be trued-up in the new rate increment or decrement.

Filing with the Authority

The Company will file calculations of shared savings and shared costs quarterly with the Authority not later than 60 days after the end of the quarter and will file an annual report not later than 60 days following the end of each plan year. Unless the Authority provides written notification to the Company within 180 days of such reports, the Incentive Plan Account shall be deemed in compliance with the provisions of this Rider. The Company will file calculations annually to verify the reasonableness of its reserve margin.

Incentive and Rewards Program

The Company will have in place an incentive and rewards program for selected Gas Supply non-executive employees involved in the implementation of the Company's PBRM in a manner consistent with the benefits achieved for customers and shareholders through improvements in gas procurement and secondary marketing activities. Participants in the program will receive incentive compensation as recognition for their contribution to the customers and shareholders of the Company through lower gas costs and savings related thereto.

During the time this tariff is in effect, the Company will continue to have in place a gas supply Incentive and Rewards Program, the details of which will be provided to the Authority on an annual basis within 60 days of the beginning of each plan year. Unless the Company is advised within 60 days, said details will become effective. No filing for prior approval is required for changes in the performance measures.